MOODY'S
INVESTORS SERVICE

New Issue: Moody's upgrades San Diego County (CA) Issuer Rating to Aaa

Global Credit Research - 12 Aug 2014

Lease and POB obligations upgraded to Aa2; Approximately $1.1 billion in debt affected

SAN DIEGO (COUNTY OF) CA
Counties
CA

Moody's Rating

ISSUE		RATING
Certificates of Participation (Edgemoor and RCS Refunding) Series 2014A		Aa2
Sale Amount	$93,000,000	
Expected Sale Date	08/25/14	
Rating Description	Lease Rental: Abatement	
Certificates of Participation (Edgemoor and RCS Refunding) Series 2014B (Taxable)		Aa2
Sale Amount	$2,000,000	
Expected Sale Date	08/25/14	
Rating Description	Lease Rental: Abatement	

Moody's Outlook STA

Opinion

NEW YORK, August 12, 2014 --Moody's Investors Service has upgraded San Diego County's Issuer Rating to Aaa from Aa1. We have also upgraded the county's outstanding lease and pension obligation bonds to Aa2 from Aa3 and assigned an Aa2 rating to the County's current offering of 2014 Refunding Certificates of Participation Series A and Series B. The outlook is stable.

RATING RATIONALE

The upgrade primarily reflects the county's consistent maintenance of a very strong fiscal position, inclusive of healthy cash and reserve levels that we expect will remain well above average, given an above average performing economy and the county's history of sound fiscal management. The county's overall credit quality also benefits from stable and prudent management, which maintained the county's resilient credit strength even during the recession. The county's exceptionally large and diverse assessed valuation, which has emerged solidly from the economic slowdown after undergoing fairly mild impacts from the recession, is another key component in the rating upgrade. The rating also reflects county residents' sound, moderately above average socioeconomic indicators, a characteristic that is particularly notable for such a highly populated area including a major city. The county's debt burden is low and entirely fixed rate, resulting in minimal probability of any credit strains resulting from its debt service obligations.

Like all California counties, San Diego is reliant upon the state for a significant portion of its revenues. As such, its credit profile is strengthened by the improved credit quality of the state as reflected in our recent upgrade of California's GO rating to Aa3. Despite the link to the state, the county soundly managed its state mandates through the downturn.

The Issuer Rating is equivalent to what the county's general obligation bond rating would be if it had any such debt. The difference between the county's Issuer Rating and its lease rating is based on the relative weakness of the pledge on the leases compared to the county's theoretical general obligation promise as reflected by the Issuer Rating. The county's pledge to repay its lease debt and pension liabilities is a contractual obligation, on parity with the county's other unsecured obligations. This promise is notably in contrast to the stronger, voter approved general obligation pledge that provides a baseline for our estimate of the credit quality of pension obligation bonds and lease pledges. Under California law, an issuer's GO pledge is an unlimited ad valorem property tax pledge. The county must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the county's general financial position.

STRENGTHS

-Exceptionally large and diverse local economy

-Strong fiscal position including healthy cash and reserve levels

-Consistent and stable management

-Improved funding environment for California counties

CHALLENGES

-Growing pension costs

-Vulnerable to Federal spending reductions as a result of unusually high military presence

-Exposure to relatively volatile state budget

DETAILED CREDIT DISCUSSION

VERY STRONG FISCAL POSITION THAT WILL CONTINUE TO IMPROVE

Despite a multi-year recession that significantly impacted general economic activity and state funding support, the county has generated stable and consistent operations resulting in a very strong financial profile. We anticipate the county's conservative budgeting practices and improving economy will produce ongoing fiscal stability and well above average cash and fund balances.

From fiscal 2007 to 2013, the county has had only one year (2009) of general fund deficit, which was a minor 1% of total general fund revenues. Over that period, the county maintained an average annual cash balance of 33.6% of revenues, a figure well above both the state and national medians and among the highest held by a Moody's-rated county with at least 800,000 residents. The county 's average annual general fund balance of 38.8% since fiscal 2007 is also among the highest of the large Aaa-rated counties. The fiscal 2013 general fund balance is 44.2% of revenues and has grown in each of last three years, a notable credit positive considering the recent stress applied to California counties.

In addition to stable general fund operations, the county's total governmental activities operating results have been unfailingly positive over the past six years. This includes operating surpluses that have averaged 5.6% of total operating revenues and net cash of no less 53% of operating revenue. The audited fiscal 2013 net cash amount of 62.3% is very strong and a result on steady increases since fiscal 2008.

San Diego County has generated such a solid financial profile due in part to a conservative and stable management team that has effectively controlled costs and adhered to well defined fiscal policies. This has resulted in actual revenues and reserves exceeding the budgeted amount by an average of 4% each year since 2010. This trend continued in fiscal 2014 with the county anticipating a $168 million increase to reserves, which would equal a healthy 46% of revenues.

The county's fiscal 2015 budget assumes a modest 0.25% revenue increase and forecasts being balanced with projected expenditures. However, the county's actual operating results are typically stronger than the budgeted amount and will likely be so again in 2015. This will be due in large part to strengthening property tax and charges for service revenues, which represent about 36 % of total revenues. Each of these areas are growing faster than the total projected revenue growth rate and will continue to do so as the economy improves.

The county is also contending with the challenge of hiring staff to fully implement the requirements of the Affordable Care Act. The addition of approximately 400 new staff has been built into the budget and we expect that the fiscal 2015 operating results will be consistent with current levels.

EXCEPTIONALLY LARGE AND DIVERSE LOCAL ECONOMY WITH QUICKENING GROWTH RATES

After undergoing minor assessed valuation contraction as a result of recession, the county's 2014 assessed valuation grew by a modest amount that was nonetheless its fastest growth rate in five years. The 2015 assessed valuation is projected to grow at an even faster rate and we anticipate that the county's economy will continue to accelerate from the downturn.

The county's assessed valuation is an immense $406 billion after growing by 2.6% in 2014. This is the largest tax base of any Moody's-rated Aaa county and is projected to grow by another 4% in 2015. San Diego has 3.2 million residents and is the fifth most populous county in the nation. Despite its large size and socioeconomic diversity, resident median family incomes are 114% of the national mark and at the higher end of the spectrum for highly populated counties. Most of this wealth is centered in the coastal portion of the county including the City of San Diego (Issuer Rating Aa3/Stable). Despite some fluctuation during recession, the county's annual unemployment rate has been lower than the state and nation each year since 2004. The current unemployment mark of 5.8% is the lowest level in six years and again below the state and national levels.

Though it is highly diverse with its top ten taxpayers accounting for only 4.5% of total assessed valuation, the county's economic strength is driven by four primary sectors: military, tourism, education and technology. The US Navy and Marine Corps have several installations in the county which are estimated to produce approximately 300,000 jobs. San Diego will likely outpace the rest of the nation in job creation due to its increasing strength in biotechnology. The economy also benefits from the institutional presence of large college and universities and remains one of the most visited regions in the state.

Indicators for continued economic growth are favorable: home values and sales continue to increase, building permits have risen by their highest rate since 2009, bank owned properties continue to diminish while the property tax collection rate is its highest ever at 99.1%. Still, the housing market is not fully recovered from the downturn as the county estimates that it has about $25 billion in home values to restore to pre-recession levels as prices increase.

LOW FIXED RATE DEBT LEVELS WITH SMALL GENERAL FUND BURDEN

The county's direct debt is low at approximately 0.3% of assessed valuation, and its total annual general fund obligation's lease payments comprise approximately 1% of its total general fund revenues, a very manageable level. Debt service from fiscal 2014 to 2027 will remain largely level before dropping significantly in 2028. Management maintains a practice of setting aside all payments for debt service at the beginning of the fiscal year in which they are due. The county does not have any variable rate debt outstanding and is not a party to any derivative products.

The current refunding will refund the county's 2005 and 2006 COPs. The COPs being refunded had reserve funds funded by a combination of cash and surety to meet the standard three-prong test. The refunding COPs will have a cash funded reserve equal to 50% of MADs. Though the lack of a fully funded reserve is a weakness relative to obligations that meet that standard, the low levels of general fund debt and the totality of the county's credit profile preclude it from warranting a rating distinction from the county's other COPs. The leased assets remain the same and are the county's skilled nursing facility and regional communications system.

The county's assets for its various other COPs and lease obligations consist of essential facilities such as its central office complex and jails. Other provisions of the COP and lease obligations include the typical features of two-years of rental interruption insurance, title insurance, and provisions for asset substitution.

Moody's adjusted net pension liability (ANPL) for the county, under our methodology for adjusting reported pension data, is a moderate at 1.72 times operating revenues, compared to less than 1 times on average in the sector as of 2011. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities.

The county's OPEB liability is unusually low with an UAAL of just $180 million, which is 7% of the county's $2.4 billion pension UAAL. The county has sought to improve its pension funding by twice making payments well above the ARC in recent years. Pension contributions exceeded the ARC by $29.6 million and $14.2 million in fiscal 2011 and fiscal 2013 respectively. The county's pension board has recently adopted a policy that will permit leveraging of up to 100% versus the prior leverage limitation of 35%. This increase in allowable leverage is less conservative compared to most pension funds' investment strategies.

OUTLOOK

The outlook is stable and incorporates our expectation that the county's economy, financial profile and debt will be wither improve or remain comparable to current levels.

WHAT COULD CHANGE THE RATING UP

-N/A

WHAT COULD CHANGE THE RATING DOWN

-Material erosion of the county's cash and general fund positions

-Protracted economic decline resulting in significantly higher unemployment weakened assessed valuation

KEY STATISTICS

Assessed value, 2014: $406 billion

A.V. per capita: $ 127,962

Estimated Median family income, 114% of national median

General Fund balance, FY 2013: 44.2% of total general fund revenues

Institutional framework: A

5 -year average operating revenues/operating expenditures: 1.02x

Net direct debt/full value: 0.3%

Net direct debt/ operating revenue: 1%

3-year average adjusted net pensions liability/full value: 1.50%

3-year average adjusted net pensions liability/operating revenues: 1.72x

The principal methodology used in the issuer rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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